2011 Wellmark Rate Filing – Internal Review Summary

To: Commissioner Susan Voss
From: Klete Geren, ASA, MAAA, Actuary
Date: December 20, 2010
Re: Summary of the 2011 Wellmark Rate Filing (Pools 3, 4, 5 and Blue Transitions)

The Division received Wellmark's annual individual rate filing last month on November 10, 2010 via SERFF. As required by the Executive Order from earlier this year, the filing will receive an independent outside review to give the public additional confidence that the proposal is reasonable and justified. The filing will undergo an internal actuarial review along with an independent analysis from Lewis and Ellis out of Overland Park, Kansas. Lewis and Ellis is a nationally recognized consulting firm with extensive experience in all lines of life and health insurance. As of this date, the external review is not complete and we are not privy to the findings from Lewis and Ellis.

Before the results of our internal review are summarized, it might be useful to provide a brief summary of the filing process in Iowa:

1. Insurance carriers are required to request and receive approval from the Iowa Insurance Division before they can change individual health insurance policy rates. Beginning in the second quarter of 2010, all major medical and hospital surgical rate filings will receive additional outside review. If the rate increase proposal is above 6.1%, a public hearing is scheduled.

2. The carrier's actuaries and attorneys submit the rate change proposal to the Division which includes the following information:

    - A general filing description that summarizes the request, i.e., x% increase proposed, a description of the policy forms affected, and the proposed effective date
    - An actuarial memorandum – this document describes the methodology and assumptions used to determine the amount of the rate increase, i.e., medical inflation, lapse rates, increases in the frequency and severity of claims, higher than expected loss ratios, etc. The memorandum also demonstrates compliance with loss ratio standards under the law. Loss ratio means the ratio of claims to premiums.
    - The experience of the policy forms subject to the rate change proposal, i.e., loss ratios of the policy forms to which the rate increase applies.
    - An actuarial certification signed and dated by a qualified actuary

3. The Division's actuarial staff (and its consultants) then analyze the carrier's claims experience (loss ratios), claim trends, rate increase history, and other assumptions to determine if the rate increase proposal is actuarially justified.

4. If the Division's staff and its consultants cannot confirm the carrier proposal, a lower increase will be proposed. This is normally accomplished via email exchanges, possible face-to-face meetings at the Division's offices, and/or conference calls with the company actuaries.

Other things to consider:

- The Division does not regulate rate changes due to age (getting a year older). The rate at which premium increase due to advancing age is essentially contractually bound based upon the *initial filing* with the Division.
- The Division does not regulate geographical area factors, nor are there any restrictions on the use of such factors in the code. The factors simply account for differences in the cost of care from one part of the state to another.
- The Division does not regulate smoker and non-smoker differentials.
- The Division does not regulate the difference in premiums between males and females.
- The Division does not regulate the difference in premiums between individual contracts vs. family contracts.

While the Division does not regulate the items referenced above, carriers cannot arbitrarily change them. As a practical matter, once the initial policy form (and the initial rates) is submitted to the Division for approval – all of the factors will remain the same throughout the life of the policy form series. In other words, the carrier is not free to change the smoker factor for example. All of the factors such as age, gender, geography, smoker, etc. – which form the basis of a final rate are essentially set in stone from the moment the initial filing is approved. By initial filing – we mean that the policy form and rates have not yet been approved by the state, nor have they been sold on the market. It is a new policy form (benefit plan) where the carrier is seeking approval from the states in which the carrier wishes to market its product.

Due to the passage of time and the effects of medical inflation, drug costs increasing, and increases in the frequency and intensity of claims – insurance carriers are allowed to increase the premiums so they can keep up with inflation. The goal of the internal and external review by the Division's consultants is to make sure that the increase is justified and that the proposed rates will satisfy State and Federal loss ratio standards. In all, the company and regulatory process is similar in that both parties try to estimate the rate at which claims are increasing. The rate at which claims are increasing can be calculated by measuring the changes or fluctuations in the loss ratios and/or claims costs. The final process involves setting the premium level so that the target or statutory loss ratio requirement can be satisfied.

As mentioned above, Wellmark submitted their filing to the Division last month; below is quick summary of the proposal, the number of the policies affected, and the effective date:

Block	Proposal	# of Iowa policies	Effective Date
Pool 3	10.8%	1,257	4-1-11
Pool 4	10.8%	13,271	4-1-11
Pool 5	10.8%	31,035	4-1-11
Blue Transitions	15.0%	2,564	4-1-11

For the Division's internal review, we employed our regular analysis by examining the loss ratios, trends in claims costs, along with setting reasonable target loss ratios. For Pool 3, we set the target loss ratio at 85%, for Pools 4 and 5 we used the Federal PPACA standard of 80%, and for Blue Transitions we set the target loss ratio at 120% since this is really a group conversion (guaranteed issue policy). While the Division does not have the NAIC model for group conversion business, the model law sets the target loss ratio at 120%.

Pool 3 Summary

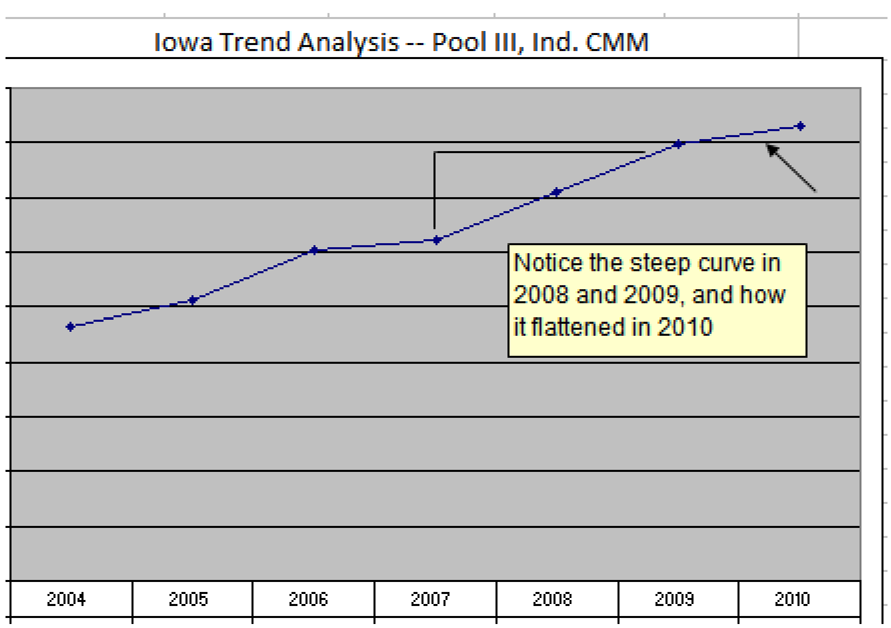
As indicated above the Pool 3 proposal is 10.8% to be effective on 4-1-11. Below is a summary of the experience:

	A	B	C	D	E	F	G	H	I
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E	(I) = D / G
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss	Trended
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (MLR)	On-Level MLR
4	2007	17,025	4.25	25,427	21,222	1.28909	27,357	80.22%	92.95%
5	2008	14,286	3.25	19,414	15,579	1.28909	20,083	91.70%	96.67%
6	2009	13,403	2.25	16,569	14,019	1.19892	16,808	95.61%	98.58%
7	2010	8,531	1.37	9,711	9,783	1.04991	10,271	87.20%	94.55%
8							Lifetime MLR	76.52%	

As you can see from Column (H) above, the lifetime loss ratio is 76.52% (as measured from 1996-2010/9months), however, the recent experience has been much worse, i.e., 92% over the last 2-years, 92% over the last 3-years, and nearly 88% over the last 4-years. These figures are much higher than the following guides:

- Higher than the current Iowa standard of 60%
- Higher than the Federal PPACA standard of 80%, and the Division's target loss ratio of 85%

The Division employs a number of advanced techniques to determine if the proposal is actuarially justified. We calculate a range of rate increase indicators using the internal Insurance Division rating template. Most of the rate increase indicators suggest that the carrier proposal is reasonably supported, however, the carrier proposal is at the high end of our ranges. The Division's trend testing template suggests that the claim trend for this block of business has leveled off in 2010 relative to 2008 and 2009 where the curve was fairly steep. I have included an excerpt from the template, where you can clearly see a flattening of the curve in 2010. Recommendation: 9%



Pool 4 Summary

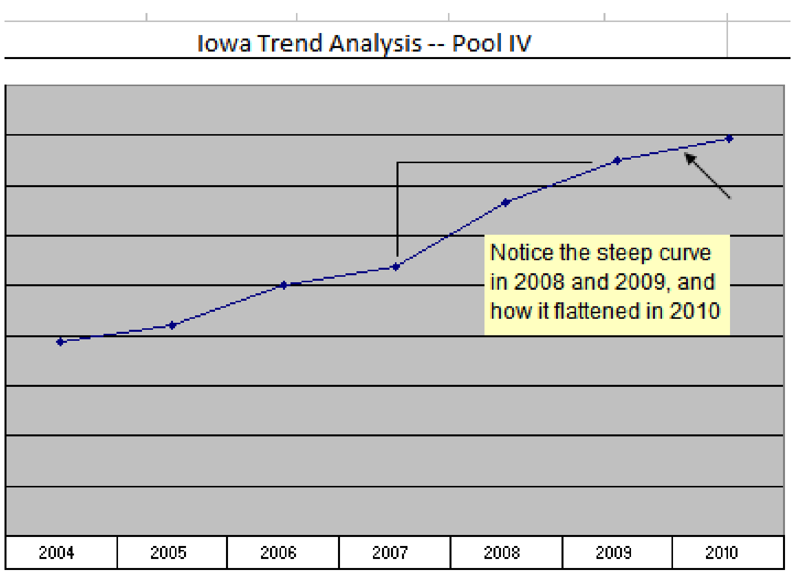
Similar to Pool 3, the Pool 4 proposal is 10.8% to be effective on 4-1-11. Below is a summary of the experience:

	A	B	C	D	E	F	G	H	I
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E	(I) = D / G
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss	Trended
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (MLR)	On-Level MLR
4	2007	93,296	4.25	148,166	118,679	1.46333	173,667	78.61%	85.32%
5	2008	82,618	3.25	117,675	90,768	1.36595	123,985	91.02%	94.91%
6	2009	75,569	2.25	96,505	80,536	1.24813	100,520	93.83%	96.01%
7	2010	47,699	1.37	55,386	56,455	1.06207	59,959	84.49%	92.37%
8							Lifetime MLR	77.19%	

As you can see from Column (H) above, the lifetime loss ratio is 77.19% (as measured from 2001-2010/9months), however, the recent experience has been much worse, i.e.,90% over the last 2-years, 90% over the last 3-years, and 86.4% over the last 4-years. These figures are much higher than the following guides:

- Higher than the current Iowa standard of 60%
- Higher than the Federal PPACA standard of 80%, and higher than the Division's target of 80%

The Division employs a number of advanced techniques to determine if the proposal is actuarially justified. We calculate a range of rate increase indicators using the internal Insurance Division rating template. Most of the rate increase indicators suggest that the carrier proposal is reasonably supported, however, the carrier proposal is at the high end of our ranges. The Division's trend testing template suggests that the claim trend for this block of business has leveled off in 2010 relative to 2008 and 2009 where the curve was fairly steep. I have included an excerpt from the template, where you can clearly see a flattening of the curve in 2010. Recommendation: 9%



Pool 5 Summary

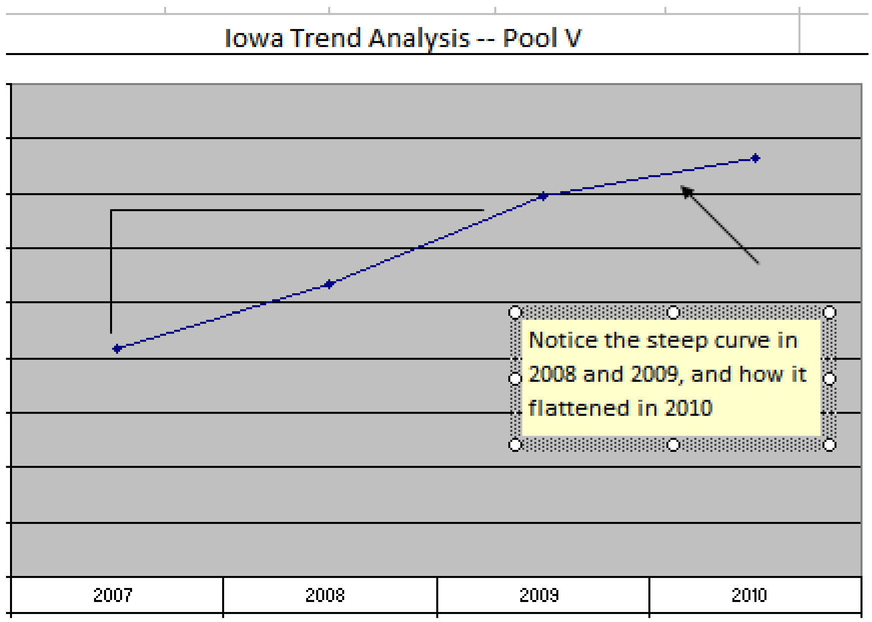
Similar to Pools 3 and 4, the proposal for the carrier's newest block of business is also 10.8% to be effective on 4-1-11. Below is a summary of the experience:

	A	B	C	D	E	F	G	H	I
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E	(I) = D / G
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss	Trended
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (MLR)	On-Level MLR
4	2007	3,520	4.25	5,741	6,593	1.27842	8,429	53.39%	68.11%
5	2008	32,139	3.25	46,717	47,205	1.27842	60,348	68.08%	77.41%
6	2009	61,697	2.25	79,906	73,214	1.20913	88,525	84.27%	90.26%
7	2010	59,159	1.37	69,285	73,359	1.05403	77,323	80.64%	89.61%
8							Lifetime MLR	78.11%	

As you can see from Column (H) above, the lifetime loss ratio is 78.11% (as measured from 2007-2010/9months), however, the recent experience has been much worse, i.e., nearly 82.5% over the last 2-years. These figures are higher than the following guides:

- Higher than the current Iowa standard of 60%
- Higher than the Federal PPACA standard of 80%, and higher than the Division's target of 80%

The Division employs a number of advanced techniques to determine if the proposal is actuarially justified. We calculate a range of rate increase indicators using the internal Insurance Division rating template. Most of the rate increase indicators suggest that the carrier proposal is reasonably supported, however, the carrier proposal is at the high end of our ranges. The Division's trend testing template suggests that the claim trend for this block of business has leveled off in 2010 relative to 2008 and 2009 where the curve was fairly steep. I have included an excerpt from the template, where you can clearly see a flattening of the curve in 2010. Recommendation: 9%



Please note that for Pool V, the Division's rating template only utilized experience in 2009 and 2010 given the immature nature of the block. This block of business was introduced in the 4th quarter of 2007, and so the experience in 2007 and 2008 (and probably 2009 as well) would have been heavily influenced by underwriting. Newer blocks of business typically perform much better due to the underwriting process, i.e., pre-existing conditions may not be covered for a certain length of time, and the benefit payments for some health conditions may be excluded altogether. In any event, it takes a few years for the target loss ratio to be realized. In this case, we chose 2009 as the beginning of the experience period where an 80% loss ratio should reasonably be expected on a going forward basis.

Blue Transitions Summary

The rate increase proposal the Blue Transitions block is 15% to be effective on 4-1-11. Below is a summary of the experience:

	A	B	C	D	E	F	G	H	I
1	(A)	(B)	(C)	(D) = BxT ^ C	(E)	(F)	(G) = E x F	(H) = B / E	(I) = D / G
2	Calendar	Incurred	Projection	Trended	Earned	On-Level	On-Level	Loss	Trended
3	Year	Claims (IC)	Length (PL)	IC	Premiums (EP)	Factors	EP	Ratio (MLR)	On-Level MLR
4	2007	0	4.25	0	0	1.34525	0	0.00%	0.00%
5	2008	2,918	3.25	3,966	2,033	1.34525	2,735	143.53%	145.00%
6	2009	13,267	2.25	16,401	8,732	1.27234	11,110	151.94%	147.63%
7	2010	13,000	1.37	14,798	11,182	1.06931	11,957	116.26%	123.76%
8							Lifetime MLR	132.97%	

As you can see from Column (H) above, the lifetime loss ratio is 132.97% (as measured from 2008-2010/9months), with similar calendar year loss ratios. These figures are significantly higher than the following guides:

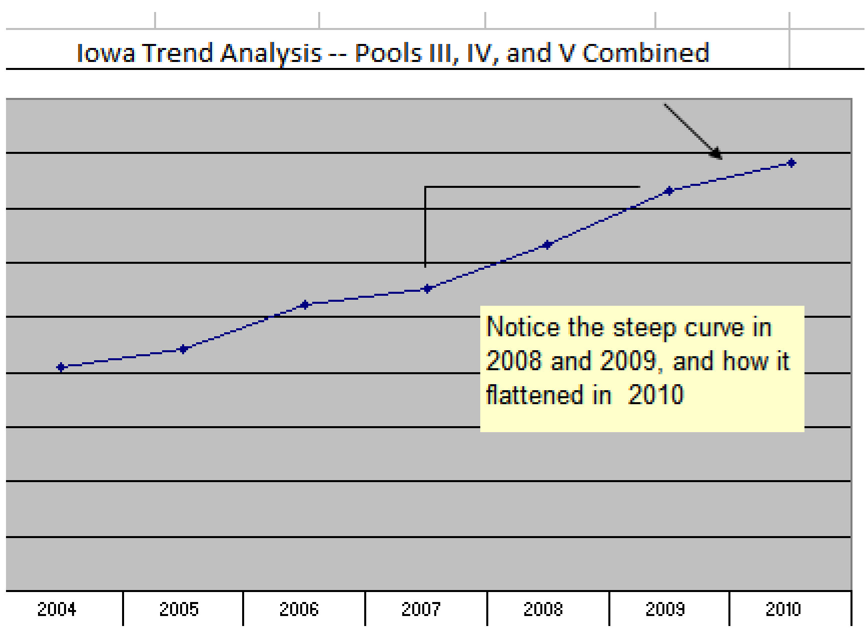
- Higher than the current Iowa standard of 60%
- Higher than the Federal PPACA proposal of 80%, and higher than the Division's target of 120%

The Division employs a number of advanced techniques to determine if the proposal is actuarially justified. We calculate a range of rate increase indicators using the internal Insurance Division rating template. Most of the rate increase indicators suggest that the carrier proposal is reasonably supported. The Division's trend testing template suggests that the claim trend for this block of business is difficult to measure using year-over-year fluctuations in the loss ratios and/or claims cost.

Please note that for Blue Transitions, the Division's rating template only utilized experience in 2009 and 2010 given that the block of business is not very mature. This block of business was introduced in the 1st quarter of 2008 and so it difficult to measure trends with only 2 or 3 data points. Given the make-up of this block (group conversion w/o underwriting), 15% appears to be reasonable given a lifetime loss ratio of nearly 133% in such a short period of time.

In summary, the internal review of the information provided within the original filing (along with additional information requested by the iid) appears to reasonably support the proposal, albeit at the high end of our range of indicators for pools 3, 4, and 5. One item of note that should be mentioned is that our internal model is very sensitive to the trend rate utilized in the projection along with the target loss ratio assumption. As discussed above, the internal model assumed a target loss ratio of 85% for Pool 3, and 80% for Pools 4 and 5. Assuming those are reasonable target loss ratios (and they are, according to PPACA), then it really boils down to what trend rate should be utilized in the projection of the loss ratios. Selecting a trend factor involves examining the stream of claim costs and/or adjusted loss ratios, where such examination might include performing calculations such as year-over-year ratios, compound growth calculations, and exponential regression on the 'logs' of the values being tested. The selection of the trend factor is also complicated by the question of how many years of data should be utilized. For example, examining the last 5-years of claims costs could yield a different trend rate than utilizing just the last 2-years.

As mentioned above, the Division's trend testing template did reveal a distinct flattening of the curve with regard to the 2010 adjusted loss ratios and the average claim costs. This suggests that the claims trend rate slowed down in 2010, however, it is very difficult to know with any degree of certainty that such a flattening is permanent in nature, or simply a one-time blip. If we accept it as a one-time blip and assume that the trend rate will return to higher levels next year, the internal models reasonably support something close to the carrier proposal. However, if we give credence to the flattening by assuming that the long term trend is indeed slowing down, then the proposal could be modified to a lower level. I have included one additional excerpt from the trend testing template (pools 3, 4, and 5 combined), where you can clearly see a flattening of the curve in 2010 relative to 2008-2009.



Given the apparent slow down of trend in 2010, I would recommend a modification of the proposal to 9.0% for pools 3, 4, and 5 and leave the Blue Transitions block at 15%.